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South Korea: Revitalizing the Rural Economy

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Summary

Seoul's three-year, \$1.7 billion rural development project announced in March is calculated to shore up flagging support for the government of President Chun Doo Hwan. The cornerstone of the plan is a long-term program to increase rural industrialization, which Seoul hopes will boost the share of off-farm earnings in rural households and maintain the relative parity between rural and urban incomes--a key yardstick South Koreans use to judge government economic policies. In addition, concessional interest rates on farm loans, lower land rental fees, and employment on construction projects will give rural incomes a temporary lift. The project is a small first step toward the government's goal of doubling off-farm earnings to 70 percent of rural income by the year 2000. In

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addition, the government aims to further wean farmers from expensive agricultural subsidies. []

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Seoul's trade negotiators claim that when implemented, the rural development initiative will go a long way toward ending US-South Korean frictions over agricultural trade, in particular, by lowering opposition to renewed beef imports. But the plan includes an import tax on agricultural goods, which could damage US interests--the likelihood of a tariff on grain is particularly worrisome. Moreover, although we believe the rural development initiative could strengthen Seoul's political support from the rural electorate--still a key constituency despite declining numbers--we are skeptical it will significantly improve the government's maneuvering room, at least in the near term, on politically sensitive agricultural trade issues. []

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The Rural Problem: The Politics

Agricultural issues have always been politically charged in South Korea, an important factor in government budgets and development strategy since the 1970s, when President Park began an expensive development effort in the rural sector. In the last 25 years South Korea has changed from a poor, agrarian society to perhaps the world's most advanced newly industrializing country, with a vigorous technology- and knowledge-intensive manufacturing sector. Seoul's rural policies have been crafted to keep farmers' incomes and quality of life from falling too far behind urban workers, who have benefited the most from South Korea's economic surge. []

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Despite the rapid growth of other sectors, agriculture and fisheries remain important to the economy--14 percent of GNP originated in these traditional industries last year--and especially important to the South Korean political equation. Our analysis shows the key factors that govern the politics of Seoul's agricultural policies include:

- Equitable distribution of South Korea's economic wealth. Rural-urban income parity is the yardstick both supporters and critics point to most frequently when assessing the equity of government economic policies. The US Embassy reports that rough parity now exists, and by any measure income in South Korea is well distributed compared with other developing countries. According to US Embassy and press reports, the average South Korean, however, sees income disparities widening, and South Korea's rapid industrialization makes income parity

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increasingly difficult to maintain. Wages paid to labor in the manufacturing sector will continue to outpace inflation, mainly because of productivity increases. South Korea's largely small-scale, capital-short farmers cannot match these gains.

- Eight million rural votes. As elsewhere, farmers tend to be conservative and are generally considered "reliable" by the ruling party. In addition, rural areas enjoy disproportionately large representation in the National Assembly.¹ As in Japan, the political equation also includes the emotional attachment of many urban dwellers to the farm or to relatives who still work the soil. Although we have no information on the number of urban votes that would turn on rural sector issues, polling data shows nearly 70 percent of the population considers unbalanced regional development to be a serious problem.
- Opposition exploitation of farm issues. Criticism of Chun's farm policy by the main opposition New Korea Democratic Party (NKDP) in the National Assembly keeps the issue of retaining rural support high on the ruling party's agenda.
- Rapid urbanization. The problems associated with rapid urbanization also make improving rural life--in order to stem the flow to the cities--an important political consideration. According to official estimates, 400,000 people yearly move from rural to urban areas; many are young people with high expectations. Seoul will soon be home to 25 percent of the population, which already has taxed its social services and infrastructure. Urban social problems have sparked only sporadic trouble so far, but South Korean politicians are sensitive to the possibility of large-scale unrest.

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Although the government recognizes the political importance of the rural sector, some of its economic policies have alienated large blocks of the rural population. According to the US Agricultural Attache, farmers still grumble about the rice support price freeze in 1983, and subsequent reductions in other price support programs--although grain and fertilizer subsidies

¹Although the 52 largely rural parliamentary election districts have an average population of 160,000, the 50 metropolitan districts average 280,000 inhabitants. Each election district has two seats.

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still are a \$1 billion annual outlay. Farmers enjoyed more than a decade of real price increases for rice and barley before the freeze, when South Korea's economic technocrats began to phase out the subsidies as part of a broader policy of fiscal and monetary austerity to combat inflation. The move was also consistent with a trend toward greater reliance on the market as the determinant of economic development. [REDACTED]

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Programs that have gone awry, particularly plans to rapidly expand beef, milk, and hog production, have further alienated agricultural interests. Agriculturalists initially welcomed these heavily promoted government programs that were intended to improve farm earnings through diversification. In fact, the programs have made producers more vulnerable to erratic price swings. According to the US Agricultural Attache, farmers hold the government politically as well as financially liable for failed policies, and an unsuccessful three-year effort to stabilize beef prices has eroded their confidence. [REDACTED]

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The Plan

In March, Seoul announced a three-year, \$1.7 billion rural sector development initiative that partially replaces the current income policy--primarily subsidies for both agricultural products and inputs--with a plan to provide manufacturing jobs to bolster off-farm income. Economic technocrats are pointing to the relatively low 35-percent share of off-farm earnings in South Korean rural incomes (Japanese farmers make 80 percent and Taiwanese farmers make 65 percent of their household incomes from nonfarm jobs) to explain the move. According to the US Agricultural Attache, however, the Economic Planning Board began formulating the development plan last October, when President Chun and ruling party leaders, concerned about rural support, pressed for action. South Korea's long-term development plans have set a target of 70 percent for nonfarm earnings for rural households by 2000. [REDACTED]

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The US Agricultural Attache reports that the main features of the rural program include:

- Rural industrialization. This is the cornerstone of the government's plan to increase off-farm opportunities. Seoul has pledged to develop 100 small industrial estates in rural areas by 1991. The new rural plan kicks off that effort, although only 11 percent of the proposed expenditures for the entire plan are specifically earmarked for industrial development. Businessmen who establish small- and medium-sized firms in these estates will be eligible for preferential financing and tax breaks. In addition, capital gains taxes will be reduced on the urban plant sites of firms relocating to the countryside. Subsidized 5-percent

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interest rates for loans with two- to 20-year terms also will be available.

- Rural welfare. The government will launch infrastructure projects such as road paving, improved telephone service, housing, and water supply systems. In addition, school facilities will be improved and the best rural students will go to vocational school tuition free. Seoul will also improve agricultural marketing channels and increase access to medical services and shopping. [redacted]

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Other shortrun features--essentially government subsidies--of the rural development initiative are designed to reduce costs in order to improve farmers' profits.

- Lower land rental fees. Tenant farmers potentially could get a \$224 million boost from a 50-percent cut in the maximum permissible land rent. In addition, a reduction in high land transfer fees will encourage farmers to buy land for agricultural production. Lowering the fees and sharply increasing property taxes for absentee landlords should encourage more farmer ownership.
- Cut rate interest on loans. Loan rates for agriculture will be cut from 10 to 8 percent. Beleaguered cattle raisers also will benefit from an additional two-year grace period on interest payments for their loans--a \$69 million windfall.
- Tariffs on agricultural imports. These tariffs will be used to finance part of the \$660 million annual cost of the program in 1987-88. The government has not tipped its hand on how this new system of levies will work, saying only that certain "nonessential" items will be taxed--coffee, almonds, and avocados are likely candidates--but according to the Agricultural Attache in Seoul, most observers predict grain imports eventually will be taxed.
- Export liberalization. Export controls on some vegetables, fruits, and fisheries products will be eased under a new export licensing procedure. Although export restrictions originally were intended to prevent excessive increases in domestic prices for key commodities, such as onions, apples, and some marine products, the practical effect was periodic price collapses during good harvest seasons and shortfalls the following season as farmers cut back plantings. [redacted]

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Benefits to Chun: The Jury Is Still Out

Like his political standing in the cities, President Chun's unpopularity runs deep even in rural areas, and farmers probably will turn a cynical eye toward this latest in a series of plans under the politically popular banner of "balanced regional development." Memories are still fresh of previous, half-hearted attempts by the government to spur rural development through programs that left few long-lasting benefits--in contrast to a more visible and effective rural development strategy under former President Park. Chun's personal style, marked by inconsistencies and policy reversals, in fact, makes us uncertain about the new program's life expectancy. Chun could decide to lower the plan's priority if it does not quickly show signs of shoring up flagging rural support. [redacted]

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In the dynamic political situation leading to 1988, however, when Chun has promised to step down at the end of his term, we believe the President will remain concerned with rural issues. He undoubtedly wants to avoid a repeat of the 1985 National Assembly elections, when ruling Democratic Justice Party (DJP) candidates were shocked to find widespread grumbling in the hinterlands over Seoul's farm policies. [redacted]

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The DJP's failure to win a plurality of the vote and a stronger than expected opposition showing in 1985 have stiffened the party's resolve to make progress on rural issues. In addition, the opposition's push for constitutional revision--the opposition New Korea Democratic Party (NKDP) favors direct presidential elections--is certain to heat up the scramble for popular support by all political players. Whether a new election system will govern the selection of Chun's successor is uncertain at this time, but a new system could embody, at least nominally, more democratic principles, thus placing a higher premium on every vote. [redacted]

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If such factors convince Seoul to aggressively follow through on the new farm plan, we believe Chun, and the ruling party, will snare some political benefits. The DJP probably correctly calculates it can steal some of the opposition's thunder on the farm issue, even though farmers and opposition leaders generally view the rural sector plan as a defensive move. To the government's credit, the plan focuses on long-term solutions to the rural-urban parity question, rather than advocating only an immediate pumping up of rural incomes. [redacted]

But if Chun carries through on implementing the rural program, he faces risks, particularly in carrying out the government's plan to limit direct income subsidies. Opposition leaders and rural interests may argue the plan is too little too late, particularly if financial relief comes slowly or

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agricultural product prices slump. Furthermore, if the government is heavyhanded in acquiring land for the industrial estates and roads, it could stir rural discontent. Finally, the foreign debt question may also expose Chun to opposition criticism. The NKDP has successfully exploited South Korea's \$47 billion foreign debt in the past and could do so again if, as economic technocrats suspect, the plan cannot be funded entirely by domestic resources. [redacted]

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Economic Impact on Rural Interests

If implemented as designed, the rural development initiative will be a plus for farmers and fishermen by next year. Cost reducing measures, particularly the land rent provisions, will help generally, while cattle producers will receive temporary relief by forgoing payment on some of their loans for the next several years. More broadly, rural interests will benefit from new employment opportunities during the infrastructure build-up, which will immediately absorb many underemployed workers until the anticipated manufacturing jobs become available. Over the longer run, the completion of infrastructure and improvements in the marketing system for agricultural and fisheries products should improve the efficiency of this sector. The net effect also should boost the quality of rural life and perhaps lower the tide of young people moving to urban areas. [redacted]

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The target group may not be the primary beneficiary of Seoul's initiative, however. For example, agricultural processing plants are among the most likely tenants for the rural industrial estates, but the import tax proposal in the plan raises questions about how profitable they can be. The Agricultural Attache in Seoul reports that the tax burden may reduce the profit margins of food processors using imported products if they cannot pass the cost along to urban consumers. [redacted]

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The benefits conferred on farmers by the rural sector initiative may work at cross purposes to Seoul's objectives in cutting subsidies to agriculture. Economic planners have tried to anticipate these problems, and in the rice case, have balanced reduced input costs, such as land rents, against reduced support prices, a strategy that will probably limit the possibility South Korea will become caught in the agricultural subsidy trap familiar to developed countries--increased supply depressing prices, forcing additional outlays for subsidies. Modest interest rate reductions for agricultural loans also pose little danger that production will increase dramatically--real interest rates remain high when adjusted for inflation, about 2 to 3 percent this year. [redacted]

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It is difficult to gauge whether the industrialization push will be successful. On the one hand, the middle- and upper-class

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entrepreneurs most likely to begin new businesses or move existing operations to rural areas would face personal and financial risks, including:

- Distance from political hubs and diminished clout.
- Fewer educational opportunities for their children--a key consideration in South Korea, where academic prestige and childhood connections help shape career prospects.
- A small pool of workers with appropriate skills and few, if any, ancillary business services.
- Longer hauls to large markets.
- Inadequate bank capital, which will be needed in large doses for operating expenses once manufacturing begins.

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On the other hand, the full range of tax breaks and subsidized credit included in the plan could attract savvy businessmen to the rural industrial estates. Moreover, Seoul's rural development plan dovetails well with its broader efforts to foster small- and medium-sized industries and to more evenly distribute capital around the country.

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Implications for the United States

The rural development initiative's impact on US interests will probably be mixed. Much of the negative effect will come in 1987, when program expenditures peak. The government's intention to raise part of the annual \$210 million rural development financing portion of the plan--about one-third of total expenditure--from an import tax on agricultural products is of particular concern. We do not know what share will come from the import tariffs--or even if goods important to US interests will be included--but economic planners will probably try to minimize the government budget's share to maintain fiscal austerity. According to the US Embassy, the Economic Planning Board is leaning toward a 5- to 10-percent blanket surcharge on agricultural imports, while the Agriculture Ministry prefers a complicated system of variable levies.

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If the special tax is extended to grain, it could reduce US agricultural sales--Seoul has already announced a 6.5-percent reduction in grain imports as one goal for 1986 and is trying to diversify grain sources. In addition, higher prices could cut demand for grain and make currently less attractive domestic forage a competitive substitute--a major goal in Seoul's import substitution policy for animal feed. We can only speculate that grain will be a tariff target, but Seoul's silence on which

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commodities will be taxed and the program's mechanics are worrisome. Seoul would probably try to avoid increasing bilateral trade frictions by factoring in Washington's views before imposing any tariffs, but the Ministry of Agriculture and Fisheries, the responsible government body, has been the least sensitive--and often most hostile--to US market access concerns. Agriculture officials could not easily back down on a tax on grain or any other product after the fact. [REDACTED] 25X1

On the plus side, Seoul is trying to use the rural development initiative to increase its leverage with rural interests that generally oppose the government's import liberalization plans for agricultural products. Deputy Prime Minister and head of the Economic Planning Board Kim Mahn Je, for example, told Washington that South Korea's ban on beef imports might be lifted once the benefits from the new program trickled down to the farm. A few weeks after the plan was unveiled, however, Kim asked for more time on beef, according to the US Embassy. The plan's success in mollifying rural interests, moreover, is largely dependent on market forces, and continued low farm gate prices for key commodities will offset farmers' income gains from the government's rural program. [REDACTED] 25X1

The political sensitivity of the agricultural import issue, moreover, will offer Seoul little room to maneuver until the rural economy improves. Mollifying individual farm constituencies--the moratorium on interest payments for cattle raisers and lower land rents for rice farmers--will probably not increase Seoul's ability to open agricultural markets as long as broader problems such as farm debt and rural income parity remain as targets for the opposition. [REDACTED] 25X1

We see no quick fixes for these problems, and the government may face a more daunting task than its ambitious 70-percent target for nonfarm earnings for rural households suggests. Only half of all nonfarm income comes from unrelated side businesses or nonagricultural wages and earnings. The rest comes largely from subsidies, money sent from relatives in the city, and rental of small plots of land. [REDACTED] 25X1

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